ORIGINAL



No. 84824-6

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

CITY OF TACOMA, a municipal corporation,

*Appellant,*

*v.*

CITY OF BONNEY LAKE, CITY OF FIRCREST, CITY OF UNIVERSITY PLACE, CITY OF FEDERAL WAY, PIERCE COUNTY and KING COUNTY,

*Respondents.*

# APPELLANT'S REPLY BRIEF

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## I. SUMMARY OF REPLY

This Court held in *Lane v. City of Seattle*, 164 Wn.2d 875, 194 P.3d 977 (2008), that fire hydrants are a general government responsibility. As a general government responsibility, taxpayers, not ratepayers, must pay for them. If the laws enacted by a general government require a public water utility to provide a local hydrant system, the costs associated with meeting such a requirement must be paid for by that general government, out of its tax revenues.

In reaching its decision in *Lane*, this Court was unpersuaded by the argument of Lake Forest Park that the local ordinance at issue requiring the water utility to provide a local hydrant system was passed prior to the Court's decision in *Okeson v. City of Seattle*, 150 Wn.2d 540, 78 P.2d 1279 (2003), holding instead that the principles laid down in *Okeson* and which would otherwise control the outcome in *Lane* should apply. *See Lane* at 889. Similar to Lake Forest Park's rejected argument, the Respondent general governments in this case (the "General Governments") argue that their franchise ordinances passed prior to *Lane* should control the issues in this case because they predate *Lane*. But while the franchise ordinances invoked by the General Governments undoubtedly were enacted at a time when this Court had yet to address the law regarding "who must pay for [hydrants]," *Lane* at 884, that fact is of no more moment for the outcome of this case than was the fact that the local ordinance involved in *Lane* predated *Okeson*.

Which leaves the terms of the franchises themselves, and specifically their indemnification and hold harmless provisions. Building on the fact that the trial court in *Lane* barred Seattle's attempt to collect the expense of hydrant services from general governments who had franchise agreements with Seattle containing such provisions (a ruling Seattle for some reason chose not to appeal), the general government parties to this case persuaded the trial court to "follow form" and similarly bar Tacoma's attempt to collect the expense of hydrant services based on virtually identical indemnification and hold harmless provisions. This ruling flies in the face of the well-established purpose of such clauses, which is to protect one party to an agreement from exposure to liability caused by the actions of the second party to the agreement over which the first party has no effective control. If this Court endorsed the General Governments' reading of these clauses, which are found in a wide variety of contracts -- perhaps most notably in the construction field, where they protect owners from liability for the actions of contractors over which the owners have little or no control during the course of a construction project -- the result would upset a myriad of contract expectations.

This Court may and should reject so manifestly unreasonable a result. Parties to a contract under both common law and the Declaratory Judgment Act are free to file suit to seek a declaration of their rights under the contract and to seek appropriate remedies based on those rights. The General Governments have not cited a single case supporting their assertion that when an indemnitor party to a contract seeks a judicial

determination of its rights, that party becomes "a person filing a claim" within the meaning of a standard form indemnification and hold harmless clause, and becomes obligated to defend and indemnify *against its own lawsuit*. If parties actually intended such a clause to operate in such a fashion, they surely would make that intent explicit -- assuming any prospective indemnitor would actually agree to such a prospective hamstringing of its rights, which should strike this Court as a highly dubious proposition, to say the very least. And whatever the likelihood that some prospective indemnitor may have or eventually will enter into such a self-debilitating arrangement, Tacoma plainly did not do that here.

And even if this Court were to conclude that Tacoma *did* do that here, the impact would only be to render the franchise agreements *ultra vires* because the result would be an illegal tax. General governments, including these general government respondents, do not have the statutory authority in Washington to enact a tax for hydrant costs under their state delegated franchising authority. *See* RCW 35A.47.040; RCW 36.55.010. Tacoma has incurred significant costs associated with providing local hydrant systems to the General Governments as required by their ordinances. Under *Lane*, the General Governments must pay for these costs out of their general funds; they may not impose those costs on Tacoma's ratepayers. Because the trial court's ruling conflicts with these basic principles of Washington law, the trial court should be reversed and Tacoma granted the declaratory relief it seeks.

## II. ARGUMENT IN REPLY

### A. Under Basic Rules of Contract Interpretation, the Standard Form Indemnification and Hold Harmless Provisons of the General Governments' Franchise Agreements Should Not Be Read to Bar Tacoma From Receiving Declaratory Relief Against the General Governments.

The General Governments do not dispute that they are responsible for hydrant system costs; however, they assert they are absolved from having to pay because of the existence of the franchise ordinances passed prior to *Lane*. To the extent the General Governments are truly making an argument of timing -- our franchise agreements predate *Lane*, therefore we win -- they are plainly wrong, as *Lane* itself made clear in rejecting a similar argument by the general government defendant in that case. *See Lane* at 889. That leaves only the argument based on the specific terms of the franchise agreements, and the General Governments have pointed to only one provision of those agreements which they claim absolves them of having to pay for hydrant services for which they must otherwise pay under *Lane*: the agreements' standard form indemnification and hold harmless provisions.

There should be no doubt that under *Lane* the General Governments are confronting having to pay for the hydrant services at issue, if they cannot escape that obligation by some indemnification sleight of hand. Tacoma operates in the General Governments' jurisdictions with their permission, and is providing hydrant services that the General Governments require Tacoma to provide. In addressing a local government's requirement to provide a hydrant system it requires a

public utility to provide, this Court in *Lane* stated: "Moreover, SPU provided the hydrants because Lake Forest Park required it to do so by ordinance....Since providing hydrants is governmental, *see above*, Lake Forest Park also consented to pay for the hydrants when it passed this requirement. True, Lake Forest park passed the ordinance before *Okeson*, but this does not avoid its liability." *Lane* at 889. That is the situation here, as well. In direct contradiction to this ruling, the General Governments argue that their preexisting franchise ordinances should absolve them from liability, while ignoring that they too passed laws requiring Tacoma provide them with hydrants. Preexisting franchise ordinances and course of conduct under such agreements do not provide a defense against liability, since this Court has ruled that passing ordinances that require hydrant services demonstrates consent to pay for hydrant services on the part of the General Governments. It simply does not matter who paid for hydrants systems prior to *Lane*; this Court has held that such costs are the responsibility of general governments who must pay them out of general funds with tax monies.

Which brings the Court to the General Government's argument that the indemnification and hold harmless provisions of their franchise agreements somehow operate to shield them from their obligation to pay pursuant to *Lane.* This is an issue of contract interpretation, and the rules of contract interpretation in Washington are well established by a series of decisions beginning with *Berg v. Hudesman*, 115 Wn.2d 657, 801 P.2d 222 (1990). In summary: Washington is a "context rule" state, under

which evidence extrinsic to the four corners of a written contract can be considered in determining the intent of the parties so long as that evidence does not vary the written terms of that contract. Here, no extrinsic evidence is at issue. The intent of the parties concerning the indemnification and hold harmless provisions therefore will be determined from the language of the franchise agreements themselves, supplemented by relevant rules of construction.

Tacoma's opening brief set forth an analysis of the indemnification and hold harmless provisions at issue in this case. Tacoma pointed out the long-established purpose of such clauses, citing to (among other authorities) this Court's decision in *Stocker v. Shell Oil Co.*, 105 Wn.2d 546, 716 P.2d 306 (1986), in which this Court described the basic purpose of indemnity agreements as "essentially agreements for contractual contribution, whereby one tortfeasor, against whom damages in favor of an injured party have been assessed, may look to another for reimbursement." *Stocker*, 105 Wn.2d at 549 (citation omitted). *See* Appellant's Opening Brief at 24. Tacoma pointed out how the General Governments' reading of the indemnification clauses at issue was plainly at odds with this purpose, and would also allow parties entitled to indemnity to avoid meeting their otherwise indisputable contract obligations, by claiming that the demand in court by their contractual co-party is a "claim" by a "person" triggering the claimant's duty to indemnify. *See id.* at 25.

The General Governments have remarkably little to say in response to this analysis. Boiled down, the General Governments' position amounts to saying, "Too bad -- since Tacoma didn't get itself excepted from the term 'person' it is stuck with the outcome at hand, and never mind the well-established purpose of indemnification and hold harmless clauses."

The General Governments ignore that when a purported contractual outcome is patently unreasonable, courts are under an affirmative obligation to reject such a result. *Berg v. Hudesman*, 115 Wn.2d at 672 (courts should reject contract readings that are "unreasonable and imprudent" and accept those that make the contract "reasonable and just"); *see, e.g.*, *Cambridge Townhomes, LLC v. Pacific Star Roofing, Inc.*, 166 Wn.2d 475, 487, 209 P.3d 863 (2009) (rejecting "unreasonable" reading of the scope of an indemnification clause); *Black v. National Merit Ins. Co.*, 154 Wn. App. 674, 683, 226 P.3d 175, *rev. denied*, 169 Wn.2d 1021, 238 P.3d 503 (2010) (rejecting "unreasonable" reading of an insurance clause which could produce "odd results"). The indemnification language at issue here, like all such language to be found in a myriad of contracts, is intended to address claims by third parties. Tacoma is not a tortfeasor, and the General Governments are not seeking contractual contribution for a tort claim brought by a third party against them and Tacoma. Tacoma had no control over the outcome of *Lane* and by the present action is simply trying to fulfill the mandate of *Lane*.

The General Governments make no effort to defend the *reasonableness* of their reading of the franchise indemnification clauses. Instead, they treat contract interpretation as some sort of game in which any "gotcha" will be enforced, no matter how unreasonable the outcome. This Court should reject the General Governments' attempt to turn this case into a game of contract "gotcha." If this Court were to endorse the General Governments' approach to indemnification clauses, under which an indemnitor loses its own right to relief against the indemnitee, unless the indemnitor thinks to expressly except itself from falling within the standard indemnification term "person," this Court would wreak havoc with the reasonable expectations of indemnitors in a wide variety of contracts (e.g., in the field of construction). This Court need not, and should not, countenance such an outcome. Instead, this Court should hold that the franchise indemnification and hold harmless clauses by their terms plainly do not shield the General Governments from making good on their obligations under *Lane* to pay for the hydrant systems at issue.

### B. The General Governments' Attempts to Charge Tacoma for the Cost of the Hydrants System in Their Local Jurisdictions Amount to Imposing a Tax Not Authorized by Statute, And Therefore Are Void.

All of the franchises include terms requiring Tacoma to pay the General Governments permit fees and administrative costs associated with managing the franchises. In addition, Respondents University Place and Fircrest force Tacoma to pay significant franchise fees -- 8 percent of earned gross revenues to University Place and 6 percent to Fircrest. These

fees are unrelated to the cost of administering the franchise ordinance, and are simply a charge assessed to Tacoma ratepayers for the privilege of operating in these jurisdictions' public rights-of-way. Although these particular fees are now potentially unlawful following *Lakewood v. Pierce County*, 106 Wn. App. 63, 76, 23 P.3d 1 (2001) (holding that fees unrelated to costs of administering the franchise agreements are impermissible), University Place and Fircrest have justified collection of these fees as consideration for agreeing to not compete against Tacoma in their jurisdictions where Tacoma has water lines.

University Place and Fircrest now seek to extend this nebulous justification, and argue they are also entitled to free local hydrant systems as consideration for the previously enacted non-compete clauses in their franchises[1]. They argue that the consideration they have paid by agreeing years ago to not compete is large enough to include extracting further consideration from Tacoma ratepayers in the form of requiring them to pay for General Governments local hydrant systems supplied by Tacoma.

The General Government Respondents argue that *Burns v. City of Seattle*, 161 Wn.2d 129, 164 P.3d 475 (2007), stands for the proposition that, not only can general governments compel municipal utilities to pay them for agreeing not to establish their own utility, they can also force utility ratepayers to directly pay for general government services this Court has ruled must be paid from the general fund.

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[1] Federal Way and Pierce County do not have non-compete clauses in their franchises.

*Burns* is not a tax case. The issue in *Burns* involved the extent of a city's authority when acting in its proprietary capacity to enter contracts with another municipal utility. In *Burns,* the fee extracted by the City of Shoreline from the City of Seattle was not done through its governmental powers of taxation and regulation; instead, this Court found that Shoreline was acting in its proprietary capacity. The parties negotiated the payment provision as consideration for Shoreline agreeing not to establish its own utility. This was not an unlawful tax or fee imposed on Seattle's ratepayers.

Contrary to the facts in *Burns*, here the General Governments are not acting in their proprietary capacity. Hydrant services have been found by this Court to be a responsibility of general governments and their general funds. When a government negotiates with a utility regarding the payment of hydrant services that the government required the utility to provide in the first place, the government is acting in its governmental capacity. Because *Lane* established that hydrant services must be paid with taxes, not fees imposed on ratepayers, the General Governments must show they have express statutory taxing authority in their governmental capacity if they desire to have utility ratepayers pay the cost of hydrants. "When a city imposes taxes and regulatory fees, it acts in a sovereign rather than a proprietary capacity." *Burns* at 150, citing *City of Tacoma v. Hyster Co.*, 93 Wn.2d 815, 821, 613 P.2d 784 (1980). The charges at issue here for hydrant services are governmental charges, not proprietary charges that can be voluntarily incurred by providing municipal utility in

the context of a franchising agreement. The General Governments have no authority to negotiate this governmental responsibility onto Tacoma's ratepayers. To decide otherwise would allow general governments to require public utilities to pay directly the costs of any general government responsibility through the device of a non-compete provision, obliterating the line between what is a tax and what is a fee. Such a result would violate the constitutional requirement that statutory tax authority be explicit. *See Okeson* at 556 (citing in part Wash. Const., art. VII, §5).

The General Governments in this action have no express authority to impose a tax on utilities for the purpose of paying for hydrant systems. It is fundamental that parties cannot lawfully agree to do by contract that which is prohibited by law -- so fundamental, in fact, that the defense of illegality of contract is one that cannot be waived. *See, e.g., Cooper v. Baer*, 59 Wn.2d 763, 763-64, 370 P.2d 871 (1962) (affirming summary judgment on grounds of illegality of contract) ("The nonenforcement of illegal contracts is a matter of common public interest, and a party to such contract cannot waive his right to set up the defense of illegality in an action thereon by the other party....[i]t becomes the duty of the court to refuse to entertain the action" (citing and quoting "the leading case" of *Reed v. Johnson*, 27 Wash. 42, 67 P. 381 (1901)). Here, the terms of the franchise cannot be construed as imposing the hydrant costs onto Tacoma ratepayers, because that would have the effect of imposing a tax for which there is no statutory authority, in turn rendering the franchise agreements illegal and unenforceable. As this Court explained in *Lane*: "The law is

not that Seattle must charge for hydrants to a broad range of taxpayers. Instead, it is simply that cities must have statutory authority to impose taxes and must enact them properly as 'taxes.' " *Lane* at 887. And here, the General Governments simply do not have the requisite "statutory authority" to impose a "tax" on utility ratepayers through their franchise authority.

In *Lane*, Lake Forest Park argued that "the heights of irony will be scaled if SPU can purchase art for its facilities and recover the costs in rates...but cannot recover the cost of complying with lawful regulations." *Lane* at 884. This Court responded that "[t]he question is not whether there will be art and hydrants, but who must pay for them...Art for public facilities is a business expense....Hydrants, like streetlights, are a government expense for which a government must pay." *Id.* at 884. Tacoma cannot incorporate the expenses of the hydrants into its rates as a business expense as suggested by the General Governments. *See* Respondents' Brief at 30. "Providing streetlights is a government function, and the court held that a municipal government must pay out of the city's general fund." *Lane* at 880, citing *Okeson*. This Court has emphasized that a general government must pay for government functions out of the government's "general fund." *Lane* at 880.

This Court did not rule that a general government can avoid its responsibilities by using language in existing contractual arrangements entered into prior to *Okeson* and *Lane*. This Court was clear that an actual payment must come from a general government to the utility that provides

government services so as to insure there is both transparency and compliance with the law regarding taxes and fees. As this Court warned in *Okeson*, "[t]here is thus an inherent danger that legislative bodies might circumvent constitutional constraints...by levying charges that, while officially labeled 'regulatory fees,' in fact possess all the basic attributes of a tax." *Okeson* at 552, quoting *Samis Land Co. v. City of Soap Lake*, 143 Wn.2d 798, 805, 23 P.3d 477 (2001). This Court should reject the General Governments' attempt to use their franchise authority to frustrate the mandate of *Okeson* and *Lane*.

### C. The General Governments Required Through Local Laws That Tacoma Provide Them With Hydrant Systems, And Tacoma Is Simply Charging the General Government for the Services They Required.

In *Lane*, this Court explained, "SPU provided the hydrants because Lake Forest Park required it to do so by ordinance. LAKE FOREST PARK MUN.CODE 15.04.015(A)(3). Since providing hydrants is governmental, *see above*, Lake Forest Park also consented to pay for hydrants when it passed this requirement." *Lane* at 889. SPU incurred numerous costs associated with providing these services. As Lake Forest Park described in its Supreme Court brief in *Lane* (as adopted from the City of Burien's brief) the hydrant services at issue include the costs SPU incurred for providing the necessary components, infrastructure and maintenance required to supply sufficient water for fire suppression. *See* City of Burien's Brief at 1, n.1 (CP 428); *see also* City of Lake Forest Park's Brief at 2 (CP 673). This Court ruled that Lake Forest Park was

liable for SPU's cost. *Lane* at 889. That cost refers to what SPU incurred installing, operating, maintaining, and replacing the hydrant system required by Lake Forest Park: "Lake Forest Park requires SPU to provide hydrants, and SPU is charging just for the costs of the hydrants required by Lake Forest Park." *Lane* at 890.

The General Governments in this case are attempting to argue that, even though they were the ones who required the specific quantities of water, water pressure, and the number and location of hydrants, nonetheless *Lane* only requires that they pay for just the hydrants themselves. But the State Accountancy Act, RCW 43.09.210, requires that "all service" render by one government body to another "shall be paid for at its true and full value by the department...receiving the same[.]" The statute does not allow the General Governments to choose what part of the service they will pay for. They must pay for all of the service "otherwise, resident taxpayers of the providing city would be paying for services to others." *Lane* at 889, n. 2.

The General Governments required through local ordinance that Tacoma provide them each a local hydrant system. The local laws indicated the type, level, and size of the service. Tacoma provided the service as required by the General Governments and incurred costs in doing so. The General Government should not be heard to complain that they do not want to pay for all of the service provided since they have already received the benefit.

Not only does *Lane* hold that Tacoma should be reimbursed for all of its costs of providing the services that the General Governments required, but the state Legislature has granted Tacoma the exclusive authority to set the rates through RCW 35.92.200, which provides:

> A city or town may enter into a firm contract with any outside municipality, community, corporation, or person, for furnishing them with water without regard to whether said water shall be considered as surplus or not and regardless of the source from which such water is obtained, which contract may fix the terms upon which the outside distribution systems will be installed and the rates at which and the manner in which payment shall be made for the water supplied or for the service rendered.

This Court has interpreted this statue as granting the providing City the sole power to set the terms of providing water service outside its corporate boundaries. In reviewing nearly identical language to the predecessor statute of RCW 35.92.200, this Court in *State ex rel. West Side Imp. Club v. Dep. of Pub. Serv.*, 186 Wash. 378, 58 P.2d 350 (1936), ruled: "We are clear that it was the intention of the Legislature, by chapter 17 of the Laws of 1933 (Ex. Sess., p. 48) to give the city sole and exclusive jurisdiction over the rates at which it would furnish water to those outside its corporate limits[.]" *See* 186 Wash. at 383. Under the statute, Tacoma is responsible for calculating the costs of providing the service and collecting from the General Governments the full amount of these costs as mandated in this Court's decision in *Lane* (as well as to be incompliance with RCW 43.09.210).[2] Any rate established by Tacoma is presumed reasonable, and

[2] RCW 43.09.210 contains no limitation, as pointed out by this Court in *Lane*, as to how far back Tacoma can recover its costs from the General Governments for local hydrant systems it provided. *Lane* at 890. Tacoma is only seeking at this time payment and statutory interest starting January 1, 2009, going forward.

the General Governments should pay in accordance with those rates. *Teter v. Clark County*, 104 Wn.2d 227, 237, 704 P.2d 1171 (1985).

## III. CONCLUSION

Tacoma requests that this Court confirm that *Lane* mandates that Tacoma may collect all of its costs incurred from the General Governments as a result of complying with the General Government laws requiring Tacoma to provide hydrant systems, and that the franchise agreements they successfully invoked before the trial court in fact cannot shield them from meeting their payment obligations. Moreover, this Court should make clear that these costs include the costs of providing the necessary components, infrastructure, and maintenance required to supply sufficient water for fire suppression.

RESPECTFULLY SUBMITTED this 2nd day of February, 2011.

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